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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 1158

ABBETT, SOMMER & CO., INC.,
CHARLES W. SOMMER, III, and
ABBETT, SOMMER & CO. MORTGAGE CORP.,
Petitioners,

v.

SECURITIES & EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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December 23, 1970

Washington, D. C. Press, Inc. 20 Mass.

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The Petitioners Abbett, Sommer & Co., Inc., Charles W. Sommer, III, and Abbett, Sommer & Co. Mortgage Corp., respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this proceeding September 25, 1970.

OPINION BELOW

There was no opinion by the Court of Appeals. The judgment of the Court of Appeals is printed in the Appendix hereto. The findings, opinion and order of the Securities and Exchange Commission appear in the Appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the District of Columbia was entered on September 25, 1970. This petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether the Securities and Exchange Commission may assume rather than prove a violation.

2. Whether the Securities and Exchange Commission may revoke a broker-dealer's license without opportunity to comply with the securities laws where there is no showing of manifest "willfulness" within the meaning of 5 U.S.C. § 558 (c).

3. Whether the Securities and Exchange Commission may revoke a broker-dealer's license without opportunity to comply with the securities law where the Commission has previously advised petitioners that their actions are legal.

STATUTORY PROVISIONS INVOLVED

United States Code, Title 5

§ 558. Imposition of Sanctions; determination of applications for licenses; suspension, revocation, and expiration of licenses.

• • •

(c) When application is made for a license required by law, the agency, with due regard for the rights and privileges of all the interested parties or adversely affected per-

sons and within a reasonable time, shall act and complete proceedings required to be conducted in accordance with sections 556 and 557 of this title or other proceedings required by law and shall make its decision. Except in cases of willfulness or those in which public health, interest, or safety required otherwise, the withdrawal, suspension, revocation, or annulment of a license is lawful only if, before the institution of agency proceedings therefore, the licensee has been given—

(1) notice by the agency in writing of the facts or conduct may warrant the action; and

(2) opportunity to demonstrate or achieve compliance with all lawful requirements.

When the licensee has made timely and sufficient application for a renewal or a new license in accordance with agency rules, a license with reference to an activity of a continuing nature does not expire until the application has been finally determined by the agency. (Pub. L. 89-554, Sept. 6, 1966, 80 Stat. 388.)

STATEMENT OF THE CASE

Century Trust Company ("Century" or "issuer") wrote mortgages for home owners on home improvements. Century requested that the staff give it a no-action letter to the effect that the sale of notes secured by the mortgages were exempt from registration under the Securities Act by virtue of Rule 234. Such opinion was issued by the staff in July 1964. The staff, having changed its mind on the exemption, instituted these proceedings in which they charged violation of the securities registration requirement. The staff also charged anti-fraud and bookkeeping violations, the former of which resulted from literature petitioners had sent the Fort Worth regional office of the Commission, requesting that they be advised if there were any anti-fraud problems with registrant's and mortgage company's literature. Petitioner, never receiving a reply, had assumed their literature was acceptable.

An evidentiary hearing was held in Ft. Worth, Texas, from June 17 through June 25, 1968, and the Hearing Examiner's Initial Decision order filed on February 5, 1969, revoked the registration of Abbett, Sommer & Co. ("registrant"), expelled registrant from membership in the National Association of Securities Dealers, barred Charles W. Sommer III ("Sommer") from association with a broker-dealer, and found Abbett, Sommer & Company Mortgage Corporation ("mortgage company") a cause of the revocation of registration. The Commission entered its findings, opinion and order (The Findings and Opinion are cited hereinafter as "Opinion") on November 10, 1969, affirming the Hearing Examiner. Petitioners filed a petition for review and an amended petition for review (with motion that it be accepted, which it was on January 5, 1970).

The Commission in its order permanently banishing petitioners from the securities industry, concluded that petitioners were not entitled to rely upon the advice of the Commission and counsel and that the petitioners had to demonstrate at trial that the literature not only was mailed to the staff but also that the staff read their mail and considered the literature. The Commission similarly held that it was not required to give the petitioner's an opportunity to comply with its revised opinion on the Century notes and the registration requirement prior to punishing petitioners for the sales of the same, and rejected the petitioners view that their good faith reliance as laymen on the advice of experts (counsel and accountants) constituted a defense to the charge of willful bookkeeping violations.

The United States Court of Appeals for the District of Columbia affirmed the Commission without opinion on September 25, 1970.

REASONS FOR GRANTING THE WRIT

THE DECISION OF THE COURT BELOW CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS AS TO THE PROPER INTERPRETATION OF 5 U.S.C. § 558(c)

Section 558(c) of Title 5 provides that "except in cases of willfulness or those in which public health, interest or safety requires" the withdrawal or suspension of a license, an administrative agency must give a licensee notice of the facts allegedly warranting such action before taking the same, and gives him the opportunity to demonstrate or achieve compliance with all lawful requirements.

Petitioners contended in the court below and contend here that the proper interpretation of willfulness is that used by the United States Court of Appeals for the Tenth Circuit in *Capital Packing Co. v. United States*, 350 F.2d 67, 79 (1965), which held that "willfulness" meant that the licensee must have committed "an intentional misdeed or such gross neglect of a known duty as to be the equivalent thereof." The petitioners relying upon a long line of cases,[1] argued that good faith reliance upon the opinions of experts such as counsel or accountants prevents a finding of willfulness.

The Commission took the position below that willfulness under 5 U.S.C. 558(c) means the mere intentional doing of the act charged and further that good faith reliance on counsel is not a defense to the charge of willful violation of the statute.

The differing interpretations of "willfulness" are analogous to the distinction found in the law of torts between the intentional torts and negligence. In the intentional torts such as assault and battery, the actor intends the misdeed—

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[1] See, *e.g.*, *United States v. Danser*, 26 F.R.D. 560, 587 (D. Mass. 1959); *United States v. Crosby*, 294 F.2d 928 (2d Cir. 1961); *United States v. Robinson*, 298 F.2d 739, 742 (2d Cir. 1962).

i.e., the harm that results. In the unintentional tort of negligence, the actor engages in the intentional doing of the act which caused harm. However, it is negligence because the actor did not anticipate, as a reasonable man would have, the result which did follow. The actor in the latter instance can be so grossly neglectful of his duty and the probable results that he will be said to have committed an intentional tort even though in reality he may not have intended harm.

The Court of Appeals for the District of Columbia has long followed the reasoning of the Commission regarding willfulness; see, *e.g.*, *Hughes v. SEC*, 85 U.S. App. D.C. 56, 64; 174 F.2d 969, 977 (1949); *Gearhart & Otis, Inc. v. SEC*, 121 U.S. App. D.C. 186, 348 F.2d 798 (1965), affirming *Gearhart & Otis, Inc.*, Securities Act Release No. 7329 (June 2, 1964); and thus have made "willfulness" equal to negligence. Thus, the court below affirmed the Commission in this case, saying that it agreed with the reasoning of the Commission and need not write an opinion.

The Tenth Circuit Court of Appeals, in concluding that "willfulness" means "an intentional misdeed" relied upon the House Report on the Administrative Procedure Act, which in discussing 5 U.S.C. § 558(c) made it perfectly clear that "Willfulness must be manifest", H.R. Rept. No. 1980, 79th Cong., 2d Sess. 41 (1946). The interpretation of this section has enormous effect on the status of all licenses and the ability of agencies to revoke them without giving opportunity to comply with the law. The continuation of differing interpretations of the law will result in differing standards of justice in the various Circuits.

This conflict in interpretation justifies the grant of certiorari to review the judgment below.

2. THE COMMISSION VIOLATES DUE PROCESS OF LAW WHEN IT ASSUMES RATHER THAN PROVES GUILT.

Counsel and the Commission issued opinions that the petitioners' actions were legal. These opinions were, in

part, based upon information supplied by the issuer—information which was false. The Commission in this case assumed that petitioners either knew or should have known that the information relied upon was false. Such conjecture is crucial for without it there is no willfulness or public interest in the revocation of the license. No direct proof of knowledge was ever introduced.

An assumption or conjecture cannot be used to prove an element of the offense so fundamental and basic to the charge itself. *United States v. Crosby*, 294 F.2d 928 (2d Cir. 1961). Thus, assumption, without supporting evidence, constitutes a presumption of guilt, whereas, in American jurisprudence, one is supposed to be presumed innocent until proven guilty. Also the assumption of a vital point such as this would be the taking of "evidence" without opportunity for cross-examination.

3. REFUSAL TO GIVE THE PETITIONERS OPPORTUNITY TO COMPLY WITH THE LAW AFTER ADVISING THEM AND CAUSING THEM TO BELIEVE THAT THEIR ACTIONS WERE LEGAL CONSTITUTES ENTRAPMENT.

The Commission held below that it could render advice that the securities held by petitioners need not be registered under the Securities Act and then prosecute someone for following that advice. The Commission reasoned that it had been misinformed on the facts of the case by the issuer who had requested the opinion. Petitioners were not the party misrepresenting the facts, but merely persons who relied upon the advice of the Commission.

The Commission argues incorrectly that it cannot be estopped from changing its mind where it had wrong facts or it misapplied the law. As a matter of constitutional due process, the Commission must give those who relied upon their advice the opportunity to comply with the reinterpretation of the act before bringing proceedings which will drive a person out of business or have other drastic effect.

Moser v. United States, 341 U.S. 41. This failure to give the petitioners an opportunity to comply with the law places the Commission in the same position as the police officer who entraps the unsuspecting defendant into violating the law. *Cf., Sherman v. United States*, 356 U.S. 369.

CONCLUSIONS

For these reasons, a writ of certiorari should issue to review the judgment of the District of Columbia Circuit.

Respectfully submitted

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December 23, 1970.

(Securities Exchange Act Release No. 8741) ADMINISTRATIVE PROCEEDING FILE NO. 3-1510

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
November 10, 1969

ABBETT, SOMMER & CO., INC.
251 University Plaza Building
Fort Worth, Texas

(8-7035)

CHARLES W. SOMMER III
ABBETT, SOMMER & COMPANY
MORTGAGE CORPORATION

Securities Exchange Act of 1934 -
Sections 15(b) and 15A

Findings, Opinion and Order

BROKER-DEALER PROCEEDINGS

Fraudulent Representations in Offer and Sale of Securities

Offer and Sale of Unregistered Securities

Noncompliance with Records Requirements

Where registered broker-dealer, its controlling person, and another company controlled by him made false and misleading representations in offer and sale of mortgage notes, which also involved unregistered investment contracts, concerning safety of investment and value of property in relation to amount of mortgage, in willful violation of antifraud and registration provisions of Securities Act of 1933 and Securities Exchange Act of 1934 and rules thereunder, and where broker-dealer and controlling person failed to maintain certain books and records, in willful violation of latter Act

and applicable rule, *held*, in public interest to revoke broker-dealer's registration, expel it from membership in registered securities association, bar controlling person from association with broker-dealer, and find affiliated company to be a cause of such revocation.

Offering of Mortgage Notes Involving Investment Contracts

Where, in purported reliance on Rule 234 under Securities Act which exempts from registration notes secured by first lien on real estate if offered in accordance with specified terms and conditions but provides that exemption is unavailable for any investment contracts involved in offering of notes, broker-dealer offered and sold mortgage notes obtained from note-discounter pursuant to provided various services, including investigation of property and mortgagor, collection of monthly payments for investors, and undertaking to repurchase notes, *held*, investment contracts were involved in offering of notes and no exemption was available.

APPEARANCES:

Joan H. Saxer and *Thomas W. McIlheran*, of the Fort Worth Regional Office of the Commission, for the Division of Trading and Markets.

Carl L. Shipley, of Shipley, Akerman & Pickett, for respondents.

Following hearings in these proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that the registration as a broker and dealer of Abbett, Sommer & Co., Inc. ("registrant") should be revoked and registrant expelled from membership in the National Association of Securities Dealers, Inc.; that Charles W. Sommer III, regis-

trant's president and sole stockholder, should be barred from association with a broker or dealer; and that Abbett, Sommer & Company Mortgage Corporation ("Mortgage Corp."), which is controlled by Sommer, should be found a cause of the revocation of registrant's registration. We granted a petition for review filed by the respondents, and briefs were filed by them and by our Division of Trading and Markets. On the basis of an independent review of the record and for the reasons set forth herein and in the initial decision, we make the following findings.

Violations in Offer and Sale of Mortgage Notes

We find, as did the examiner, that between December 1960 and April 1965 respondents, in connection with the offer and sale of certain mortgage notes, willfully violated, or willfully aided and abetted violations of, the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder and the registration provisions of Sections 5(a) and 5(c) of the Securities Act. The notes in question, generally executed by home owners for home improvements and secured by first mortgages on the properties, were purchased by respondents from Century Trust Company ("Century") or sold as agent for Century. That Company was engaged in the business of buying such notes at a discount from building contractors and others and reselling them "with recourse" against it in the event of default by the note maker.[1] Respondents sold over 600 of these notes to about 150 customers for more than $1.3 million.[2] The sales were effected by registrant prior to July

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[1] If a payment on a note was overdue by more than 90 days, Century agreed to repurchase the note from the investor at a price representing the total remaining principal balance of the investor's purchase cost.

[2] In addition to the notes sold to respondents, a large number of notes were sold by Century to another finance company, to savings and loan associations, and to its stockholders.

1963, and thereafter by Mortgage Corp., which was organized for that purpose by Sommer and, as found by the examiner, "lacked a palpable identity distinct from" registrant since it had the same officers and employees and used registrant's stationery.

We agree with the examiner that materially false and misleading representations were made to customers by respondents, in letters or orally, in the offer and sale of the mortgage notes. These representations were to the effect that the notes were guaranteed in such a manner that "you can only gain" by investing in them, that the only risk was from inflation, that the notes were as safe as deposits in savings accounts, or that the notes were "as good as gold". The safety of such investment, however, was largely dependent on the financial ability of Century to repurchase notes in the event of default,[3] which in turn was dependent on various factors including the profitability of its operations and the volume of notes presented for repurchase. While a note purchaser also had the security of the mortgaged property, foreclosure in the event of default in payments would likely be costly and time-consuming. Moreover, it was improper to compare the safety of the notes with savings account deposits, which are normally insured by a government agency. In addition, as found by the examiner, sales literature used by respondents falsely represented that the mortgage never exceeded 75% of the value of the property or that the value of the property normally was from two to six times the amount of the mortgage, when in fact the amount of the mortgage at times exceeded the entire value of the property.

Respondents argue that our Regional Office, although in frequent communication with them concerning sales literature and despite respondents' request for advice, never advised them that the literature violated the antifraud pro-

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[3] In April 1965, Century stopped honoring its recourse obligations because of financial difficulties which eventually culminated in bankruptcy proceedings.

visions. Apart from the question whether our staff was required to furnish such advice,[4] however, there is no indication in the record that prior to commencement of its investigation following the period under consideration, our staff saw respondents' correspondence, or was aware of the oral representations referred to above or that the underlying property values were not as represented. It is no defense that some of the more sophisticated investors may have, as asserted, realized that an investment in mortgage notes was attended by inherent risks.[5] And there is no basis for the intimation by respondents that investor witnesses were improperly coached by our staff, or for respondents' argument that the examiner should not have credited the testimony of "disappointed investors."[6]

The record also supports the finding of the examiner that the offer and sale of the notes, as to which no registration statement under the Securities Act had been filed or was in effect, were not exempt from the registration requirements of that Act pursuant to Rule 234 thereunder. That Rule exempts from registration promissory notes directly secured

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[4] *Cf. Capitol Leasing Corporation*, Securities Exchange Act Release No. 4714, p. 5 (August 18, 1964).

[5] The record does not bear out respondents' assertion that the investor witnesses were all experienced business persons or sophisticated investors. We note that a number of them had been solicited to purchase the mortgage notes after responding to registrant's newspaper advertisements offering higher interest rates for savings and loan deposits. In any event, the sophistication of customers is irrelevant, and it is not necessary to show reliance on a broker-dealer's representations or that customers were in fact misled in order to establish violations of the antifraud provisions. See *Hamilton Waters & Co., Inc.*, Securities Exchange Act Release No. 7725, p. 6 (October 18, 1965) and cases there cited; *Richard N. Cea*, Securities Exchange Act Release No. 8662, p. 6 (August 6, 1969); *Richard J. Buck & Co.*, Securities Exchange Act Release No. 8482, p. 9 (December 31, 1968), *aff'd sub nom. Hanley v. S.E.C.*, F.2d (C.A. 2, July 24, 1969).

[6] See *Batkin & Co.*, 38 S.E.C. 436, 422, n. 11 (1958); *Richard N. Cea*, *supra*, at p. 7 of cited Release; *Richard J. Buck & Co.*, *supra*, at p. 9 of cited Release.

by a first lien on real estate if offered in accordance with specified terms and conditions, but provides that no exemption is available for any "investment contract . . . the offering of which is involved" in the offering of the notes.[7] Contrary to respondents' contention, an investment contract was involved in the offering of the mortgage notes.

The term "investment contract" is not defined in the Securities Act. However, the Courts and this Commission have concluded that various contracts which in form involved nothing more than the sale of interests in real estate or chattels were in fact investment contracts and therefore securities because accompanied by an offer of or representation concerning services upon which the investor relied to obtain a profit on his purchase.[8]

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[7] Investment contracts as well as notes are included within the definition of "security" in Section 2(1) of the Securities Act. While Rule 234 did not become effective until January 1961, shortly after registrant and Sommer began the sale of the mortgage notes, in pertinent respects the exemptive provisions which it superseded (Regulation A-R) contained essentially the same terms and conditions. And while that Regulation did not in terms specify that the exemption was not available for investment contracts involved in the offering of first lien notes, this had been our long-standing position. See Securities Act Release No. 3892 (January 31, 1958).

Among the conditions specified in Rule 234 is that the amount of the indebtedness secured shall not exceed 75% of the appraised value of the mortgaged property. As we have seen, the indebtedness at times exceeded the entire value of the property. In addition, a number of the notes sold by respondents were secured by a second, rather than a first, lien on the property. However, the instant review of the initial decision does not include issues as to compliance with the terms and conditions of the Rule and we make no adverse findings in these respects.

[8] See, *e.g.*, *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (assignments of oil leases on small tracts, coupled with seller's undertaking to drill test well); *S.E.C. v. W.J. Howey Company*, 328 U.S. 293 (1946) (sale of small tracts of land in citrus grove, coupled with contract for cultivating, marketing and remitting proceeds to investors); *Blackwell v. Benton*, 203 F.2d 690 (C.A. 5, 1953) (sale of tracts which were part of larger tract to be developed as citrus grove, coupled with management contract); *Continental Marketing Corporation v.*

In a public release issued in 1958,[9] we stated that arrangements providing for various services to investors in connection with offerings of mortgages frequently constitute investment contracts. We enumerated some of the more common services and other arrangements which had come to our attention, each of which in our opinion would have a bearing on whether an investment contract was involved. Such arrangements include a complete investigation and placing service, the servicing of collection, payments and foreclosure, a guarantee against loss or provision of a market for the underlying security, advances of funds to protect the security of the investment, circumstances necessitating complete reliance on the seller such as the existence of great distances between the mortgaged property and the investor, and the selection by the seller of mortgages for investors. The release pointed out that "the wider the range of services offered and the more the investor must rely on the promoter or third party, the clearer it becomes that there is an investment contract." On the other hand, as noted in the release, where such services are offered, the fact that "the purchaser looks solely to his own mortgage or deed of trust for income or profits will [not] obviate the requirements for registration."

The record shows that Century investigated each note and mortgage to determine, among other things, the value of the underlying property, the existence of prior liens, and the credit standing of the mortgagor. While prospective investors, a large proportion of whom was solicited by respondents in the Fort Worth area of Texas, were free to inspect properties prior to puchase, this was seldom done.

S.E.C., 387 F.2d 466 (C.A. 10, 1967) (sale of beavers which purchasers were encouraged to leave with a rancher for breeding); *National Resources Corp.*, 8 S.E.C. 635 (1941) (assignment of oil and gas leases on small tracts, coupled with representation regarding drilling operations).

[9] "Public Offerings of Investment Contracts Providing for the Acquisition, Sale or Servicing of Mortgages or Deeds of Trust," Securities Act Release No. 3892 (January 31, 1958).

partly because many of the properties were located at a considerable distance from that area within Texas, and others were in Louisiana and at least one in Arkansas.[10] In some instances, respondents, after ascertaining the amount which a customer wanted to invest, selected for him a note or notes approximating that amount. Century collected the monthly payments from the mortgagors and remitted them to the note purchasers. Although, as previously noted, it undertook to repurchase notes when any payment was more than 90 days delinquent, in a number of instances, where note makers were delinquent in their payments, Century made such payments with its own funds. In addition, respondents represented to some purchasers that they would be willing to repurchase the notes at any time. In their sales literature respondents stressed the "guarantee" of the notes by Century, the strong financial position of that company, the services provided by Century for the noteholders, and Century's record of prompt repurchase of defaulted mortgages.

We do not consider it significant that in the "investment contract" cases previously cited the service were designed to create a profit, whereas in the present case the services were directed essentially toward minimizing the risk involved in the investment. In both types of situations, the investor relies upon the services and undertakings of others to secure the return of a profit to him. We are satisfied that under the principles enunciated in the cases and stated in our release, the arrangements and representations pursuant to which the mortgage notes were offered gave rise to the creation of investment contracts within the meaning of Section 2(1) of the Securities Act.[11]

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[10] For example, a widow residing in Fort Worth and later Houston invested about $90,000 in 36 mortgage notes which were secured by properties in Louisiana and in widely scattered parts of Texas.

[11] *Cf. Los Angeles Trust Deed and Mortgage Exchange v. S.E.C.*, 285 F.2d 162 (C.A. 9, 1960), *cert. denied* 366 U.S. 919.

Respondents claim that we are estopped from finding that an exemption was unavailable because in October 1964, about six months before the close of the relevant period, our staff advised Century and Sommer that although the question whether Century's agreement to service the mortgage notes constituted an investment contract was not free from doubt, it appeared that the Rule 234 exemption would be available provided the notes were offered subject to the terms and conditions specified in the Rule.

Aside from the fact that the doctrine of estoppel cannot be invoked against the Commission,[12] the record shows that the representations of Century's counsel, made in a July 1964 letter which Sommer saw and on which our staff's interpretation was essentially based, were as Sommer knew or should have known not in conformance with the facts or misleading in material respects. Inconsistent with the representation that the notes were secured by properties in Texas, some of the properties, as noted above, were located in Louisiana and Arkansas. While the record does not indicate that these out-of-state properties were farther removed from investors who purchased the notes relating to them than properties which might have been in remote parts of Texas, the difference in applicable laws would tend to increase the reliance of investors on Century.[13] In addition, a representation that selection of the notes was made by the purchasers was misleading because, as noted above, at least in some instances respondents selected a note or notes for customers after ascertaining the amount they wanted to invest. Moreover, while Century's counsel represented to our staff that the only guarantee offered by Century was the "with

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[12]See *John W. Yeaman, Inc.*, Securities Exchange Act Release No. 7527 (February 10, 1965), and the court decisions cited at p. 9, n. 16, of the Release.

[13]Century's president stated that Louisiana law relating to liens is quite different from Texas law and that foreclosure is more difficult and expensive in Louisiana.

recourse" endorsement, which became applicable in the event of a 90-day delinquency in payment by the note maker, as previously mentioned Century occasionally made the payments itself and respondents represented to some purchasers that they would repurchase the notes at any time. Under the circumstances, respondents cannot shield themselves behind the staff interpretation, particularly in view of the indication by our staff that the question whether investment contracts were involved was not free from doubt. Respondents should have been aware that any deviation from the facts described to our staff that would cause investors to place more reliance on respondents or Century would be likely to bring the offering into the investment contract area.

Respondents further contend that any violations of the registration provisions were not willful. They assert that they relied in good faith on the advice of Century's counsel that an exemption was available for the offering of the notes, as well as on the interpretation by our staff in October 1964. They state that they had no power to bring about registration of the securities and claim that "at worst" they were engaged in good faith in broker-dealer transactions which are exempt from registration under Section 4 of the Securities Act.

With respect to the claimed reliance on Century's counsel, respondents apparently have references to counsel's July 1964 letter to our staff as well as to a September 1960 letter by him to Century's president. It is well established that reliance on the advice of counsel does not negate willfulness.[14] Moreover, as we have previously indicated, Sommer was or should have been aware that the representations in the 1964 letter were inaccurate or inadequate. And the 1960 letter merely stated that since the terms and conditions of our regulation were "apparently" being met, there was no need to register the notes. The letter did not discuss

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[14] *Gearhart & Otis, Inc.*, Securities Exchange Act Release No. 7329 (June 2, 1964), at p. 34 of cited Release, *aff'd* 348 F.2d 798 (C.A.D.C., 1965).

the services provided by Century with respect to the notes, much less those subsequently provided by respondents. Respondents therefore cannot claim to have relied in "good faith" on counsel's advice.[15] Nor, in light of our discussion of the staff interpretation, is there any substance to respondents' claim of good faith reliance on it.

Respondents' remaining contentions are similarly without merit. Their asserted inability to bring about registration of the investment contracts by Century cannot excuse the sale of securities in violation of the registration provisions. Registrant and Mortgage Corp. were underwriters within the meaning of Section 2(11) of the Securities Act,[16] or co-issuers with Century, and as such their sales were not exempt from registration. It is clear that respondents' violations of Section 5 were willful since they knew that no registration had been effected and they knew or should have known that no exemption was available.[17]

Violations of Record-Keeping Provisions

We also sustain the examiner's findings that registrant, willfully aided and abetted by Sommer, willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. Inspections by our staff at various times between April 1960 and November 1966 disclosed, among other things, that certain records were not posted on a current basis, customers' accounts did not reflect the date of delivery or receipt of securities, receipts and deliveries of securities in and out of accounts with other brokers and dealers had

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[15] *Id.*, at p. 9, n. 13, of cited Release.

[16] That Section defines "underwriter" to include a person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security.

[17] *Cf. Strathmore Securities, Inc.*, Securities Exchange Act Release No. 8207, pp. 4, 8, 9-11 (December 13, 1967), *aff'd* 407 F.2d 722 (C.A.D.C., 1969); *Armstrong, Jones and Company*, Securities Exchange Act Release No. 8420, pp. 7-8 (October 3, 1968), appeal pending.

not been recorded, securities position records were inaccurate, and memoranda of brokerage orders, instead of showing both time of entry and, to the extent feasible, time of execution, showed only one time of day without characterizing it.

Respondents concede that they made errors in record-keeping and do not challenge any of the examiner's specific findings of deficiencies. They assert that they sought the advice of certified public accountants and legal counsel and that, despite their repeated requests for guidance, our staff merely made vague and indefinite criticisms. However, as previously indicated, reliance on advice of counsel or other experts does not preclude a finding of willfulness. And, contrary to respondents' assertion, registrant was repeatedly advised of specific record-keeping deficiencies uncovered during inspections by our staff as well as admonished to comply with applicable requirements. In any event, registrant and Sommer cannot shift their responsibility in this respect to our staff. Certainly, they were aware that records must be accurate and current.

Other Matters

Respondents contend that they were not given an opportunity to achieve compliance prior to the institution of proceedings, as required by Section 9(b) of the Administrative Procedure Act ("APA") (5 U.S.C. §558(c)). They further argue that the failure to make Century a party to these proceedings deprived them of a meaningful opportunity to defend themselves; that Section 7(c) of the APA (5 U.S.C. §556(d), requiring that administrative agency action be supported by "reliable, probative and substantial evidence," calls for considerably more than a preponderance of the evidence; and that respondents were denied their constitutional rights against self-incrimination by not being advised, during our staff's investigation, that they could claim a right not to testify or produce records and that the evidence obtained therefore cannot be used against them.

None of these arguments has any merit. These proceedings are within the exceptions expressly provided in Section 9(b) of the APA for cases of willfulness or those in which the public interest requires otherwise.[18] Respondents have not indicated in what respects the failure to make Century a party hampered their defense. Moreover, in proceedings under the Exchange Act such as these, which are remedial rather than penal in nature,[19] allegations of willful violations need be proven only by a preponderance of the evidence.[20] Finally, the record shows, contrary to respondents' assertion, that when Sommer was called to testify during our staff's investigation, he was advised of his privilege against self-incrimination. And such privilege does not permit the withholding of corporate records[21] or of "'records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation and the enforcement of restrictions validly established.'"[22]

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[18]See *Lile & Co., Inc.*, Securities Exchange Act Release No. 7644, p. 3 (July 9, 1965), and cases there cited; *Dlugash v. S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967).

[19]*Wright v. S.E.C.*, 112 F.2d 89, 94 (C.A. 2, 1940); *Pierce v. S.E.C.*, 239 F.2d 160, 163 (C.A. 9, 1956); *Associated Securities Corp. v. S.E.C.*, 283 F.2d 773, 775 (C.A. 10, 1960); *Blaise D'Antoni & Associates v. S.E.C.*, 289 F.2d 276, 277 (C.A. 5, 1961), *reh'g denied* 290 F.2d 688.

[20]See *Norman Pollisky*, Securities Exchange Act Release No. 8381, p. 9 (August 13, 1968); *James De Mannos*, Securities Exchange Act Release No. 8090, p. 5 (June 2, 1967), *aff'd* without opinion (C.A. 2, October 13, 1967).

[21]*George Campbell Painting Corp. v. Reid*, 392 U.S. 286, 288-89 (1968).

[22]*United States v. Shapiro*, 335 U.S. 1, 33 (1948). See also *Hayden Lynch & Co., Inc.*, Securities Exchange Act Release No. 7935, p. 10 (August 10, 1966).

Public Interest

In concluding that the public interest required the imposition of the designated sanctions upon the respective respondents, the examiner referred to the gravity and extended duration of their violations. He also stated that there were no mitigating factors and found that, on the contrary, Sommer was an evasive and argumentative witness, was slow and reluctant in producing records pursuant to subpoena and deliberately disposed of records of Mortgage Corp., after Century's financial difficulties became known, in order to prevent the use of such records against him. Respondents urge that the proposed sanctions are excessive, and that it would be unfair to "punish" them for the bankruptcy of Century and the resulting losses to investors. However, the sanctions are not based on the factors cited by respondents; indeed, in our opinion, the fraud violations alone would be sufficient to support them. The record reflects gross indifference by Sommer and his companies to basic requirements of the securities acts and the standards applicable to those engaged in the securities business, which, taken together with the other factors noted by the examiner, make it in our view inconsistent with the public interest to permit their continuance in the securities business.[23]

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[23] Respecting respondents' argument that such sanctions would amount to cruel and unusual punishment in violation of the Eighth Amendment, particularly since Sommer would be "barred for life from a gainful occupation," it suffices to point out as noted above that broker-dealer proceedings under the Exchange Act, which specifically authorizes the imposition of such sanctions, are remedial rather than penal in nature, and that under the Exchange Act and applicable rules Sommer is not precluded from applying for permission at some future time to reenter the securities business upon an appropriate showing.

Respondents' exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent that they are inconsistent or in accord with our decision.

Accordingly, IT IS ORDERED that the registration as a broker and dealer of Abbett, Sommer & Co., Inc., be, and it hereby is, revoked and that registrant be, and it hereby is, expelled from membership in the National Association of Securities Dealers, Inc.; that Charles W. Sommer III be, and he hereby is, barred from association with a broker or dealer; and that Abbett, Sommer & Company Mortgage Corporation be, and it hereby is, found a cause of the revocation of the registration of Abbett, Sommer & Co., Inc.

By the Commission (Chairman BUDGE and Commissioners OWENS, SMITH and NEEDHAM), Commissioner HERLONG not participating.

Orval L. DuBois
Secretary

By: Nellye A. Thorsen
Assistant Secretary

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

[no opinion]

No. 23,658 September Term, 1970

[Filed: Sep. 25, 1970]

ABBETT, SOMMER & CO., INC., CHARLES W. SOMMER, III, and ABBETT, SOMMER & CO. MORTGAGE CORP.,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Petition to Review an Order of the Securities and Exchange Commission.

Before: WRIGHT, TAMM and LEVENTHAL, Circuit Judges.

JUDGMENT

This case came on to be heard on the briefs and appendix of the parties, and was argued by counsel. While the issues presented occasion no need for an opinion, they have been accorded full consideration by the court. *See* Local Rule 13(c).

This court is in general agreement with the reasoning of and the result reached in the order of the Securities and Exchange Commission in this case dated November 10, 1969. Moreover, it finds no violations by the Commission of the Administrative Procedure Act requiring reversal.

On consideration of the foregoing, It is ORDERED and ADJUDGED by this court that the order of the Securities and Exchange Commission on review herein is hereby affirmed.

Per Curiam

Dated: September 25, 1970.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1158

ABBETT, SOMMER AND COMPANY, INC., ET AL.,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The court of appeals did not render an opinion. The opinion of the Securities and Exchange Commission (Pet. App. 1a-15a) is not yet reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 16a-17a) was entered on September 25, 1970. The petition for a writ of certiorari was filed on Decem-

ber 23, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether petitioners' conduct was willful within the meaning of 5 U.S.C. 558(c).

2. Whether the issuance by the Commission's staff of a letter stating that the offer and sale of certain mortgage notes would be exempt from registration under the Securities Act estopped the Commission from imposing sanctions upon petitioners for offering and selling the unregistered notes when it developed that the submitted facts upon which the staff's opinion was expressly based were, as petitioners knew or should have known, materially at variance with the actual circumstances surrounding the offer and sale of the notes.

STATUTE INVOLVED

The pertinent provisions of 5 U.S.C. (Supp. V) 558 are set forth in the petition at pages 2-3.

STATEMENT

Petitioners seek review of the affirmance of an order of the Commission revoking the broker-dealer registration of petitioner Abbett, Sommer and Company ("registrant"), expelling registrant from membership in the National Association of Securities Dealers, Inc., unconditionally barring registrant's president and sole stockholder, petitioner Charles W. Sommer, III ("Sommer"), from association with any broker or dealer, and finding petitioner Abbett, Som-

mer & Co. Mortgage Corporation ("Mortgage Corporation") to be a cause of the revocation of registrant's broker-dealer registration.

The Commission found that petitioners had willfully violated, or willfully aided and abetted violations of, the registration and antifraud provisions of the Securities Act of 1933 and the antifraud provisions of the Securities Exchange Act of 1934 in the offer and sale of mortgage notes and investment contracts to public investors, and had willfully violated the recordkeeping provisions of the Securities Exchange Act (Pet. App. 1a-15a). The Commission held that petitioners willfully made false and misleading representations to customers in connection with the offer and sale of the mortgage notes,[1] including misrepresentations as to the safety of the investment, and the value of the mortgaged property securing the notes (Pet. App. 4a). The Commission also held that the offer and sale of these notes involved "investment con-

[1] Petitioners purchased the notes in question from, and sold them as agents for, Century Trust Company. The notes were typically executed by home owners, as payments for home improvements, and were secured by mortgages on the properties improved. Century was in the business of buying these notes at a discount from building contractors and others and reselling the notes "with recourse" (against Century) in the event of default by the note maker. The Commission found that petitioners sold more than 600 such notes to approximately 150 customers, at prices totalling more than $1.3 million. Prior to July 1968, sales were made by registrant and thereafter by Mortgage Corporation, which the Commission described as being "organized for that purpose by Sommer" and which " 'lacked a palpable identity distinct from' registrant since it had the same officers and employees and used registrant's stationery." (Pet. App. 3a-4a).

tracts" which petitioners knew or should have known were subject to the registration requirements of the Securities Act (Pet. App. 6a, 11a). The Commission rejected petitioners' claim of good faith reliance on the advice of counsel for Century Trust Company ("Century"), and reliance on a 1964 letter from the Commission's staff (Pet. App. 11a), finding that petitioners knew or should have known that the facts on which both the staff interpretation and the opinion of Century's counsel were based were incorrect (Pet. App. 9a).[1] Accordingly, the Commission found that petitioners' violations of the registration requirements were willful since they knew that no registra-

[1] By letter dated October 1964, the Commission's staff advised Century and Sommer that the Rule 234 exemption from registration under the Securities Act appeared to be available to the Century mortgage notes, provided that the notes were offered and sold within the terms and conditions specified in that rule. As the Commission found, "the record shows that the representations of Century's counsel, made in a July 1964 letter which Sommer saw and on which our staff's interpretation was essentially based, were as Sommer knew or should have known, not in conformance with the facts or misleading in material respects" (Pet. App. 9a). Century's counsel had represented to the Commission's staff, for example, that the notes in question were secured by properties located in Texas only, that purchasers made their own selection of notes, and that the only guarantee offered by Century with respect to the notes was the "with recourse" endorsement (Pet. App. 9a-10a). Contrary to these representations, the Commission found that some of the notes were secured by properties in Louisiana and Arkansas, that petitioners selected notes for many of their customers, that in the event of a default on the notes, Century occasionally made the payments itself, and that the petitioners had advised customers that Century would repurchase the notes at any time (Pet. App. 9a-10a).

tion statement had been filed and knew or should have known that no exemption was available (Pet. App. 11a).

In considering the sanctions to be imposed upon petitioners, the Commission stated (Pet. App. 14a):

> The record reflects gross indifference by Sommer and his companies to basic requirements of the securities acts and the standards applicable to those engaged in the securities business, which, taken together with the other factors noted by the examiner, make it in our view inconsistent with the public interest to permit their continuance in the securities business.

The court of appeals affirmed the Commission's order without opinion (Pet. App. 16a-17a).

ARGUMENT

The court below correctly upheld the Commission's findings and order, and the petition presents no question warranting further review.

1. Petitioners contend (Pet. 5-6) that the Commission erred in barring them from the securities business without affording them prior notice and an opportunity to comply with the law, pursuant to Section 9(b) of the Administrative Procedure Act, as amended, 5 U.S.C. (Supp. V) 558(c) (set forth at Pet. 2-3). The Commission expressly found that petitioners' conduct brought this case within the exceptions for cases of "willfulness" or "public interest" contained in Section 9(b) and that prior notice and opportunity to comply were thus not required (Pet. App. 13a). Petitioners argue, however, that the Com-

mission applied an erroneous definition of willfulness and that, under any definition, petitioners' conduct was not willful because they acted in good faith reliance on the advice of counsel for Century Trust Company ("Century") and the 1964 staff letter.

"Willfulness" under Section 9(b) of the Administrative Procedure Act has been defined by the Commission and most courts to mean the intentional doing of an act which is prohibited; a finding of specific intent to violate the law has not been required. See, *e.g.*, *Goodman* v. *Benson*, 286 F.2d 896, 900 (C.A. 7); *Eastern Produce Co.* v. *Benson*, 278 F.2d 606, 609 (C.A. 3); *Great Western Food Distributors* v. *Brannan*, 201 F.2d 476, 484 (C.A. 7), certiorari denied, 345 U.S. 997; *Schwebel* v. *Orrick*, 153 F. Supp. 701, 705 (D. D.C.), affirmed *per curiam*, 251 F.2d 919 (C.A. D.C.), certiorari denied, 356 U.S. 927. While there is language in the Tenth Circuit's opinion in *Capitol Packing Co.* v. *United States*, 350 F.2d 67, 78-79, cited by petitioners (Pet. 5), that a finding of "willfulness" can only be premised upon an "intentional misdeed" or "gross neglect," the holding of that case—which found the requisite intent even under the stricter test—does not conflict with the decision below.

Moreover, the record shows that petitioners' violations were willful even under their definition. Petitioners' false and misleading representations as to the value of the mortgaged properties securing the notes, for example, were either intentional or grossly negligent, since petitioners knew or should have known the true value of the properties. In addition, as the Commission found, petitioners sold securities which

they knew were not registered when they knew or should have known that no exemption was available, and Sommer and registrant failed to keep current or accurate records as required by the Securities Exchange Act, even though they were repeatedly advised of specific recordkeeping deficiencies by the Commission's staff (Pet. App. 11a-12a).

The Commission also properly rejected, on the basis of the record, petitioners' contention that they relied in good faith on the advice of Century's counsel and the interpretation of the Commission's staff and were not aware they were violating the securities laws (Pet. 5; Pet. App. 9a-10a). Contrary to petitioners' contention, the Commission did not assume that they either knew or should have known that the information on which the Commission's staff interpretation in 1964 and the opinion of Century's counsel were based was incorrect (Pet. 7). The Commission found, with substantial evidentiary support, that Sommer saw the representations of Century's counsel, made in a July 1964 letter, on which the 1964 interpretation of the Commission's staff was based and that Sommer knew or should have known that the representations in that letter did not conform with the true facts or were materially misleading (Pet. App. 9a).

2. Petitioners also err in contending that the Commission was estopped from imposing sanctions for their participation in the sale of the unregistered securities because of the staff's 1964 letter (Pet. 7-8). The staff there stated that its opinion as to the registration exemption was limited to the facts that had been disclosed. The Commission found that

petitioners were not justified in relying upon the 1964 letter in that they knew or should have known that the facts represented to the staff were not accurate (Pet. App. 9a-10a). In any event, as the Commission noted in its opinion (Pet. App. 9a), the doctrine of equitable estoppel cannot be invoked to prevent an administrative agency from enforcing the law. *Automobile Club* v. *Commissioner*, 353 U.S. 180, 183; *United States* v. *San Francisco*, 310 U.S. 16, 32. Accord, *Capital Funds, Inc.* v. *Securities and Exchange Commission*, 348 F.2d 582, 588 (C.A. 8); *Securities and Exchange Commission* v. *Culpepper*, 270 F.2d 241, 248 (C.A. 2); *Securities and Exchange Commission* v. *Morgan, Lewis & Bockius*, 209 F.2d 44, 49 (C.A. 3).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1971.

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